2 0 0 3 ANNUAL REPORT

# MEGAWHEELS TECHNOLOGIES INC.

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## DID YOU KNOW?

The most popular reasons to go online between the times of 5 p.m. and 10 p.m. is for Breaking News and Classifieds.

Source: Newspaper Association of America 2002, Online Consumer Studies

# Chairman's Message

## Megawheels is now positioned as a world leader in web-centric classified advertising platforms

Chris Bulger, Chairman and CEO, Megawheels Technologies Inc.

**Dear Shareholder:**

I'm very pleased to report that Megawheels has survived the recent dot.com downturn, and is now positioned as a world leader in web-centric classified advertising platforms.

With the sustained advertising market share shift achieved by GlobeMegawheels in the greater Toronto area, our business model has now been replicated in both large and small markets, in Canada and abroad. By the end of 2003, our success in the automotive sector prompted client driven diversification of our media platform into the real estate advertising vertical. We began 2004 with the implementation of IrishTimesProperty.com and have since experienced continuing financial improvement.

While financial results illustrate a substantial turnaround, they fell short of the original breakeven objective for 2003, reflecting the decision to increase investment in Technology R&D, Customer Service and Marketing, as well as the implementation of a longer sales cycle. Overall, revenues decreased by 18% to $2,399,084, which reflect completion of the transition from revenue sharing agreements, to lower fee but higher margined technology licensing contracts with newspapers.

On October 31, 2003, The Company received strong public endorsement by The Irish Times at the World Association of Newspapers conference in Rome. Liam Holland, Advertising Sales Manager, confirmed that the Megawheels business model has resulted in a 33+% increase in auto sector advertising revenue. This achievement took place in the context of a marketplace that has decreased 12%, and without requiring incremental internal staff resources.

In addition, the debut of Megawheels' Showroom SE occurred at the World Association of Newspapers' Annual Conference in Dublin last June. Phillip Crawley, Publisher and CEO, The Globe and Mail (Canada's National Newspaper©), portrayed Megawheels as effectively enabling key competitive differentiation, thus representing a successful convergence business model of Bell GlobeMedia. Further, a third party analysis of the GTA auto advertising market by Cochran and Company recently concluded that GlobeMegawheels has obtained a significant 15%+ market share shift in one of the most competitive newspaper markets in North America.

"What we have managed to achieve over the past 18 months with Megawheels, is to launch a revolutionary suite of products, create new revenue and new revenue streams, and have done so cost effectively without any increase in staff resources. Total classified motor revenue has increased by over 33% during this period in a depressed market where car sales have fallen 12%. We are also now significantly ahead of plan in property following the launch of IrishTimesProperty.com in September, 2003 with Megawheels."

Liam Holland
Advertising Sales Manager, The Irish Times

The original Megawheels technology plan uses the Web to better connect auto dealer inventory with their media partners, thereby improving the effectiveness of advertising, lowering operating costs while building the relationships necessary to provide full enterprise Dealer Management Systems over time. The Company continues to upgrade the Drive Enterprise DMS platform and to maintain a dealer-centric view with respect to improving the media desktop utility of Showroom SE.

The Company is also near the completion of a parallel technology product suite created for the real estate advertising sector. Powered by Megawheels, IrishTimesProperty.com was re-launched on September 1, 2003, and now offers ShowSuite as the enabling platform for estate agents and realtors. The second phase of this project will debut in January, 2004, and entails integration of web content into a printed weekly newspaper supplement.

We have continued to re-organize with a view towards further improving efficiency while also supporting the anticipated growth of Megawheels. We believe that improving our levels of Customer Service will create a higher probability of providing increased revenue from product sales to existing clients than would scaling sales activity predominantly towards new customers. Consequently, we are budgeting to replicate our successful formula in Ireland, where a Megawheels employee is now resident in the Irish Times office, providing account management. Combined with the creation of an in-house marketing group, we expect to significantly shorten the sales cycle for new revenue in the future.

Chairman continued on Page 2

## FINANCIAL HIGHLIGHTS

| | 2003 | 2002 | Improvement |
|---|---|---|---|
| Net Income(Loss) | ($1,549,064) | ($4,002,624) | 61% |
| Earnings per Share - Basic and Diluted | ($0.07) | ($0.19) | 63% |
| EBITDA | ($1,296,530) | ($2,207,640) | 41% |
| Equity Raised | $1,936,155 | | |

# A Meeting of Great Minds.

## The 2004 Annual General Meeting

Shareholders and members of the public are cordially invited to attend

Megawheels Technologies Inc. is proud to announce speeches from special guests:

**Mr. Phillip Crawley, Publisher of The Globe and Mail**
**Mr. Cal Dallas, Publisher of The Red Deer Express**

TSX:MWT

Red Deer, Alberta
Monday, March 1, 2004
12:30 pm

Black Knight Inn
2929 50th Avenue
Red Deer, AB T4R1H1 CA

# Chairman

Continued from page 1

We have been able to grow our share of the automotive category against our competitors, in one of the most competitive newspaper markets in North America, by creating new automotive products for our readers and the automotive community. The Globe's share has grown consistently since the introduction of GlobeMegawheels in 1999."

**Phillip Crawley**
Publisher and CEO, The Globe and Mail (Canada's National Newspaper©)

Our newest media partnership, The Red Deer Express, is also a strategically important project for Megawheels. This new partnership represents an exciting and progressive advertising alternative for the original visionaries of Megawheels and the Auto Dealers of Red Deer, while providing the next stage of our community newspaper initiative, which focuses on the needs of both the weekly and daily newspaper segments. From the vantage point of a larger newspaper customer base, the corresponding number of dealers will increase within our media platform, thereby creating a larger customer base that should be receptive to a warm technology up-sell and subsequent follow on transaction and enterprise system sales.

Our clear commitment in fiscal 2004 is to achieve a self-sustaining profitable operation, from which our customers and shareholders can enjoy long-term value creation. On behalf of the Company, I wish to express a sincere thank-you for the support from our major shareholders, VIMAC Ventures, Royal Bank of Canada, Bell GlobeMedia, MDC Corporation, INSEAD Alumni Network, and to the many individual investors who share our entrepreneurial vision. I must also acknowledge a particular debt of gratitude to our employees, whose dedication continues to make Megawheels one the most exciting technology driven growth realities of 2004.

T. Christopher Bulger
Chairman and CEO
Megawheels Technologies Inc.

# Client Services Turns the Corner

## Client Services' is committed to the success of their clients

Client Services have had a busy year this year for a number of reasons. Megawheels' renewed focus on customer support and business efficiencies have meant the relocation of the department from the Toronto Office to our head office in Calgary. This has enabled us to streamline the department in line with future strategy.

A renewed focus on revenue generation from the department has also played a major part in the reshaping. The up-sell of new functionality to current customers has enabled the self funding of the department and given the customer service personnel renewed goals while also maintaining the high level of customer service required.

"Client Services are the central point of contact for all of our customers," said Kathy Cherniak, Director of Client Services. "Having a strong support team allows us to offer superior customer service throughout the entire Megawheels experience. Client services are committed to ensuring that all we do within the organization is of direct value to the customers."

Kathy has worked hard with her team to standardize the processes and documentation used within the department. The knowledge base that they have created over the last year has enabled them to react to customer enquires in a more efficient and timely manner.

"Megawheels is clearly committed to providing New York auto dealers with a Media Desktop application that has proven to increase the effectiveness of advertising and lower operating costs"

**Joe Stella**
Vice President New Media, The New York Daily News

In the next year, the goal is to have a dedicated customers service person embedded within all of our media partners around the world to facilitate growth and deal with questions even more efficiently than at present This has been a superb year for client services who have build a firm foundation to build on in the next 12 months.

# Management Discussion

## Management's discussion and analysis of results of operations and financial conditions

The following discussion should be read in conjunction with Financial Statements of the Corporation for Fiscal Year Ended August 31, 2003

### Results of Operations

For the fiscal year ended August 31, 2003, the Company reported an overall operating and net loss of $1,549,064, compared to a loss of $4,002,624 for fiscal 2002. These results reflect a 61% year over year improvement resulting from Management's efforts to restructure operating results, as initiated at the end of the 2001 calendar year. With a lowered operating cost structure and broadened technology product suite, plus the continued support of equity partners, Management is confident that the Company is better positioned to take advantage of opportunities in the automotive and real estate sectors.

### Revenue

Earned revenue for the 2003 fiscal year ended August 31, 2003 decreased 18% to $2,399,084, compared to $2,926,188 in fiscal 2002. The decrease was primarily due to the amendments of the agreements with certain of the Company's media partners, from low margin profit sharing arrangements to technology licensing. This decrease was offset partially by revenues resulting from additional media partners and a corresponding increased dealer count during the year.

### Operating Costs

Overall, operating costs (general and administrative, sales and marketing, customer support, printing and distribution, and software development and support) decreased 26%, from $5,230,045 for the year ended August 31, 2002 to $3,868,059 for the 2003 fiscal year. General and administrative costs decreased by 19%, while sales and marketing and customer support increased by 22% and 54% respectively, reflecting the Company's focus on increasing its level of support to existing clients and to seek new revenues from both current and new media customers. Software development and support costs increased by 19% due to R&D expenditures necessary for the Company to deploy a Microsoft.Net automotive media product offering, launch a parallel real estate sector product suite, and upgrade Dealer Management Systems. Since the Company has amended its revenue and expense sharing arrangement, it did not incur printing and distribution costs for fiscal 2003.

### Interest Expense

Interest expense decreased by 75% during the year. This decrease was largely due to the interest forgiven by Bell Globemedia on its $1,000,000 convertible debenture which converted on June 4, 2003 into Common Shares.

### Depreciation and amortization

Depreciation and amortization decreased by 88%. The decline resulted from an overall writedown in the value of the Company's capital assets at the end of the previous fiscal year.

### Taxes

In light of continuing operating losses, the Company has again provided a valuation allowance for the full amount of future income tax assets at August 31, 2003. Accordingly, there are no future income tax recoveries reflected in the current or prior years' statements of operations. At August 31, 2003 the Company has significant loss carryforwards for income tax purposes which may be applied against taxable income of future years. These are comprised of approximately $14 million of Canadian losses, $488,000 of U.S. losses, and $1.8 million of losses from the U.K. operations.

### Financial condition and liquidity

As at August 31, 2003 the Company had cash of $238,715 compared to $196,897 at August 31, 2002. Cash used in operating activities decreased from ($2,217,912) in fiscal 2002 to ($1,872,489) for the 2003 fiscal year ending August 31, 2003. Negative EBITDA (Earnings before Depreciation Interest and Taxes) decreased from ($2,207,640) in fiscal 2002 to ($1,296,530) fiscal 2003, representing a 41% improvement in cashflow as defined by EBITDA. While not a standard measurement under Canadian Generally Accepted Accounting Principles, the Company believes EBITDA is an appropriate measure of operating performance. However, EBITDA could be defined differently by other companies and should be considered in addition to, not as a substitute for, other measures of financial performance including revenues and operating income. The decrease resulted from Management's focus on reducing overall discretionary costs. The Company's working capital deficiency was ($423,397) compared to ($2,238,484) for the 2002 fiscal year end. This improvement is a direct result of the conversion of $2,798,660 principal amount of convertible debt during the year.

### Events subsequent to August 31, 2003

During September, 2003, the Company entered into agreements for the issuance of additional convertible promissory notes for a total principal amount of $122,400. The notes are convertible into approximately 1,020,000 Series C Preferred shares of the Company at the option of the holders. The noteholders will also receive approximately 1,020,000 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at any time until one year after the date on which the offering is completed. VIMAC Ventures LLC cancelled an off-setting number of warrants to structure a non-dilutive funding round for new investors and leave the fully diluted capital structure at 91 million shares post funding.

### Future operations

The Company's ability to continue ongoing operations is dependent upon the ability to generate sufficient cash flow and to obtain sufficient financing necessary to fund its business to the point of achieving profitable operations. The Company has implemented a restructuring plan to improve efficiency and competitiveness. This improved cost structure, plus estimated incremental funding of $500,000 combined with new media agreements, is expected to enable the Company to achieve a break-even position during fiscal 2004 and enable incremental R&D.

### FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those contained in such statements. Readers are cautioned not to place undue reliance on these statements, which reflect Management's analysis only as the date hereof. Although new material developments will continue to be press-released as they are experienced, the Company undertakes no obligation to publicly release any revision to these forward-looking statements, in order to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are referred to the foregoing Management's Discussion and Analysis, including discussions of financial condition and liquidity and results of operations, which could cause actual results to be materially different from such forward-looking statements.

# The Megawheels Philosophy

## An accountability to their partners, investors and employees

"Megawheels is committed to enhancing the stanch relationship between Newspapers and the Automotive, Real Estate, and the Careers sectors by facilitating efficient and effective advertising and operational technologies and services. Megawheels is also committed to providing superior technology to industry professionals, providing complete customer satisfaction, quality product development and support, increased operational efficiency, accurate and responsible financial planning and reporting, and providing a fair and equitable work environment for its employees."

Megawheels Mission Statement

The successes of Megawheels have been a direct result of the close relationships we have built with our partners over the years. As many technology companies have created vendor relationships with their customers, Megawheels has consistently strived to create a partnership. Our partners' success is our success. This is no more evident than in our long standing relationship with The Globe and Mail and The Irish Times but also equally holds true with our other, more recent partners.

Megawheels' commitment to bolstering and growing these relationships is the keystone of our business strategy. To establish this solid foundation, it requires Megawheels to fully understand our partners' needs, their customer's needs, and create an efficient dialog to build strategies and manage challenges to best achieve our common goals.

Several initiatives that have taken place over the years have proven successful to strengthen our relationships and expediting our partners' success. The most visible of these initiatives is our on-site Client Service and Support representation. Initially developed as a short term launch strategy, the benefit to both Megawheels and our partners was realized with our first full time on-site representation in Ireland in 2002. A similar approach was employed in Toronto with The Globe and Mail and has created a renewed spirit of cooperation and collaboration in 2003. It is a Megawheels directive to deploy this program with all our partners to ensure their success.

Megawheels has a diverse complement of professionals with experience in retail automotive, publishing, real estate, design, customer support, and, of course, technology development to provide expertise and guidance for our partners. With our roots in automotive systems and advertising, Megawheels provides a sales and support mechanism to our partners creating an increased competitive advantage.

The deployment of the redeveloped Megawheels product technology for media providers and automotive retailers in September 2002 provided a flexibility to expand our offering into other industry verticals. This includes, but not limited to, Real Estate as was evident in September of 2003 with the introduction of IrishTimesProperty.com and ShowSuite for real estate professionals.

The Megawheels philosophy extends not only to our partners but also to our greatest asset - our employees. Megawheels offers an exciting and dynamic environment for its employees and has attracted a competent, creative, and dedicated team. The attitude of achievement is evident in the products that are developed, the relationship that are supported and enhanced, and the precision of the administrative and operational teams.

Megawheels is accountable to its partners, industry professionals, employees, and investors as is echoed in the Megawheels mission statement.

# The Globe and Mail's market share has increased

## Growth has been nothing short of dramatic

Since The Globe and Mail launched its Toronto automotive section GlobeMegawheels in 2000, its growth has been nothing short of dramatic, according to a recent study by Cochran & Company, Inc.

To help document the impact of utilizing Megawheels' leading edge Web-to-Print technology to power both The Globe and Mail's weekly automotive section and its Web site (globemegawheels.com), the consulting firm of Cochran & Company, Inc. was retained to conduct an independent study of the Toronto automotive display advertising market.

Prior to the launch of the GlobeMegawheels, The Globe and Mail did not publish a weekly automotive section. The results of the study showed that in less than four years GlobeMegawheels section captured a 30% share of the display automotive advertising surpassing two of its daily competitors, Drivers Edge published by the National Post and Drivers Source published by the Toronto Sun, and pulled within 10 percentage points of the Wheels section published by the Toronto Star.

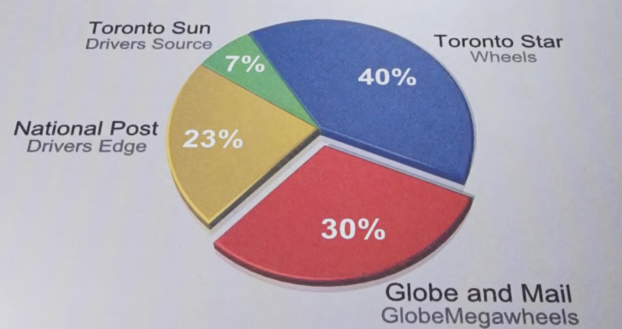
Overall, The Globe and Mail captured 23% of the total automotive display advertising published by the above four metropolitan daily newspapers.

"GlobeMegawheels is a unique and powerful automotive offering for consumers," said Helen Cochran, president of Cochran & Company, Inc. "In addition to significant new car advertising from national manufacturers, dealer associations and local automotive dealers, GlobeMegawheels offers an extensive used car inventory through the use of Megawheels Web-to-print category. The result is a complete automotive destination for readers."

"The Globe and Mail has been able to win significant market share against our three daily competitors by offering something different to the dealer community," Phillip Crawley, publisher of The Globe and Mail.

### GREATER TORONTO AREA MARKET SHARE SHIFT

The Globe and Mail has achieved a 30% market share of display advertising in the weekly automotive sections published by the daily newspapers in Toronto and a 23% market share of total automotive display advertising amongst daily newspapers in the Greater Toronto Area.




Source: Cochran & Company, Inc.'s Toronto Automotive Advertising Study conducted the week of October 19, 2003. Due to the various publication formats of the four daily newspapers, display advertising inches were converted a standard 10 column broadsheet format. Cochran & Company, Inc. October 2003 Toronto Automotive Advertising Study

## Local and National Automotive Advertising Online: Review and Outlook

Source: Newspaper Association of America, October 2003, The Digital Edge

Auto dealers and manufacturers are beginning to shift their advertising and marketing budgets to the Web. Total auto spending on the Web now represents 4.5 percent of all auto ad dollars, with $150 million flowing to local newspaper sites. While these revenues are promising, competition lurks from auto verticals and aggregators. If newspapers don't adjust their strategies, competitors such as AutoTrader.com and Autobytel could take big chunks out of current newspaper ad budgets during a period of rapid growth for the industry.

## Real Estate Advertising 2003: Bracing for Change

Source: Newspaper Association of America, The Digital Edge

Subtle changes in the flow of advertising dollars since 1996 shows the real estate industry moving toward targeted opportunities as home sales head for an anticipated slowdown, according to a new report by Borrell Associates Inc. Weekly newspapers, the Internet and cable TV were the big gainers as advertisers shifted spending from free-distribution homes magazines and telemarketing. But the biggest jockeying of all was on the Internet, where realty firms have broadly embraced a new listings-sharing policy to establish Web sites that rival media companies' listing sites.

# Easy acquisition - automatic distribution

## New technology drives revolutionary efficiencies

In mid-September, 2002, Megawheels launched its next generation product offering with the introduction of Showroom 3.0, the Branded Vehicle Search Site, and Publisys 4.5. Using the Microsoft .NET development environment and framework, Megawheels developed a core of technologies and database architecture facilitating a highly scalable and deployable product suite.

As evidenced in September of 2003, Megawheels was able to repurpose its technology for use in a Real Estate product suite with the launch of Showsuite and the Branded Property Search Site under the brand of IrishTimesProperty.com.

The flexibility of the technology enables Megawheels to explore a variety of technical advancements and product expansion, some of which are already experiencing successful Beta cycles.

### Wireless Acquisition

Megawheels' technology enables the dealer to eliminate the tethers to their desk and hard line connectivity by allowing the data acquisition to happen on the lot, where the vehicles are. This not only enables more accurate information to be gathered for the vehicle but also increases the level of detail of the data for better use in individual classified advertising.

### Data Distribution

Megawheels' proven model also makes the distribution of data virtually instantaneous. With predefined configurations, the dealer can now distribute and present the same information with several different sources across differing mediums.

Using the enhanced Media Management capabilities of Showroom SE (and now Showsuite), the dealer can quickly and efficiently build, proof, and order Classified ads using Megawheels' robust Ad Builder technology.

### Market

Megawheels will be introducing market specific products and more technical advancement over the coming months and years. Providing increasing utility is a key objective as we implement integrations between Manufacturers and Publishers, establishing an environment of brand consistency with maximum flexibility and efficiency for Retailers.


Megawheels Acquisition and Distribution Model

# Consolidated Financial Statements

Megawheels Technologies Inc. - August 31, 2003 and 2002

## Management Report

**To the Shareholders of**
**Megawheels Technologies Inc.**

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to financial statements. In the opinion of management the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the financial statements.

Management maintains appropriate systems on internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

Ernst & Young LLP, an independent firm of chartered accountants, has been engaged to audit the consolidated financial statements in accordance with auditing standards generally accepted in Canada and to provide an independent professional opinion.

Martin Hilsenteger
President

T. Christopher Bulger
Chairman and CEO

## Auditors' Report

**To the Shareholders of**
**Megawheels Technologies Inc.**

We have audited the consolidated balance sheets of Megawheels Technologies Inc. as at August 31, 2003 and 2002 and the consolidated statements of loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
October 7, 2003

Ernst & Young LLP
Chartered Accountants

### CONSOLIDATED BALANCE SHEETS

[See Incorporation and Basis of Presentation - Note 1]

| As at August 31 | 2003 $ | 2002 $ |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and cash equivalents | **238,715** | 196,897 |
| Trade accounts receivable [note 6] | **424,026** | 271,497 |
| Inventory | **9,669** | 12,930 |
| Prepaid expenses and deferred charges | **28,966** | 58,497 |
| Due from related companies [note 6] | – | 31,959 |
| | **701,376** | 571,780 |
| **Capital assets [notes 3 and 6]** | **418,686** | 527,950 |
| | **1,120,062** | 1,099,730 |
| **LIABILITIES AND SHAREHOLDERS' DEFICIENCY** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **518,364** | 878,686 |
| Due to shareholders [note 4] | – | 57,460 |
| Convertible debentures/notes [note 5] | **570,247** | 1,855,522 |
| Current portion of capital lease obligations [note 7] | **36,162** | 18,596 |
| | **1,124,773** | 2,810,264 |
| **Capital lease obligations [note 7]** | **40,271** | 34,271 |
| **Commitments [note 12]** | | |
| **Shareholders' deficiency** | | |
| Share capital [note 8] | **28,560,730** | 24,739,810 |
| Shares to be issued [note 8] | – | 424,305 |
| Contributed surplus [note 5] | **71,872** | 219,600 |
| Deficit | **(28,677,584)** | (27,128,520) |
| | **(44,982)** | (1,744,805) |
| | **1,120,062** | 1,099,730 |

See accompanying notes

On behalf of the Board:

Director Director

### CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

| For the years ended August 31 | 2003 $ | 2002 $ |
|---|---|---|
| **Revenue** | **2,399,084** | 2,926,188 |
| **Other income [note 4]** | – | 122,522 |
| | **2,399,084** | 3,048,710 |
| **Operating expenses** | | |
| General and administrative [note 6] | **1,204,340** | 1,481,919 |
| Sales and marketing | **760,853** | 621,531 |
| Customer support | **932,047** | 606,009 |
| Printing and distribution | – | 1,703,347 |
| Software development and support | **970,819** | 817,239 |
| Interest expense [note 5] | **83,152** | 333,045 |
| Depreciation and amortization [note 3] | **169,382** | 1,461,939 |
| Loss on settlement of convertible debentures [note 5(g)] | **50,000** | – |
| Foreign exchange (gain) loss | **(222,445)** | 26,305 |
| | **3,948,148** | 7,051,334 |
| Loss before income taxes | **(1,549,064)** | (4,002,624) |
| Future income taxes [note 11] | – | – |
| Net loss for the year | **(1,549,064)** | (4,002,624) |
| Deficit, beginning of year | **(27,128,520)** | (23,125,896) |
| Deficit, end of year | **(28,677,584)** | (27,128,520) |
| Basic and diluted loss per share [note 2] | **(0.07)** | (0.19) |

See accompanying notes

Consolidated Financial Statements continued on Page 6

# Consolidated Financial Statements

Continued from page 5

CONSOLIDATED STATEMENTS OF CASH FLOWS

| For the years ended | 2003 $ | 2002 $ |
|---|---|---|
| **CASH WAS PROVIDED BY (USED FOR):** | | |
| **Operating activities** | | |
| Net loss for the year | **(1,549,064)** | (4,002,624) |
| Add (deduct) non-cash items: | | |
| Reduction in due to shareholders [note 4] | – | (122,522) |
| Depreciation and amortization | **169,382** | 1,461,939 |
| Accreted interest expense [note 5] | **82,864** | 153,149 |
| Interest settled by issuance of shares | **100,038** | 15,338 |
| Loss on sale of capital asset | **18,965** | 2,563 |
| Loss on settlement of convertible debentures | **50,000** | – |
| Foreign exchange gain | **(205,445)** | – |
| | **(1,333,260)** | (2,492,157) |
| Net change in non-cash working capital [note10] | **(539,229)** | 274,245 |
| Cash used in operating activities | **(1,872,489)** | (2,217,912) |
| **Investing activities** | | |
| Decrease in due from related companies | **31,959** | 55,517 |
| Purchase of capital assets | **(28,662)** | (27,179) |
| Cash from investing activities | **3,297** | 28,338 |
| **Financing activities** | | |
| Common share issue costs | – | (3,500) |
| Issuance of preferred shares, net of issue costs | **411,323** | 424,305 |
| Issuance of convertible debentures, net of issue costs | **1,524,832** | 1,277,906 |
| Repayment of capital lease obligations | **(25,145)** | (9,057) |
| Cash from financing activities | **1,911,010** | 1,689,654 |
| Increase (decrease) in cash and cash equivalents | **41,818** | (499,920) |
| Cash and cash equivalents, beginning of year | **196,897** | 696,817 |
| Cash and cash equivalents, end of year | **238,715** | 196,897 |
| Supplementary information: | | |
| Cash interest paid | **9,891** | 3,916 |

See accompanying notes

# Notes to Consolidated Financial Statements

## 1. INCORPORATION AND BASIS OF PRESENTATION

Megawheels Technologies Inc. (the "Company" or "Megawheels") is incorporated under the laws of Canada and operates in one principal business segment as a provider of automotive dealership management software systems, internet based automotive marketing databases and automotive print advertising systems and services in Canada, the United States, the United Kingdom, and Ireland.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presumes the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company has incurred significant operating losses and cash outflows from operations and has a working capital deficiency of $423,397 and a deficit of $28,677,584 at August 31, 2003. The Company's ability to continue as a going concern is dependent on achieving profitable operations and upon obtaining additional financing. The outcome of these matters cannot be predicted at this time. These financial statements do not contain any adjustments to the amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue in business.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenue and expenses during the period. Actual results may differ from these estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### a) Consolidation

These financial statements include the assets, liabilities and results of operations of the Company together with its wholly owned subsidiaries Megawheels Limited, Megawheels Corporation, Megawheels Technologies (Ireland) Limited, 1058626 Alberta Inc. and Megawheels Technologies Partnership. All inter-company transactions and balances have been eliminated upon consolidation.

### b) Cash and cash equivalents

Cash and cash equivalents includes investments in highly liquid money market instruments with original maturities of less than ninety days, which are readily convertible to known amounts of cash, subject to insignificant risk in changes of value and which are held to meet operating requirements.

### c) Inventory

Inventory consists mainly of computer hardware and is stated at the lower of cost, on a first-in first-out basis, and net realizable value.

### d) Capital assets

Capital assets are recorded at cost and amortized based on estimated useful lives as follows:

| | |
|---|---|
| Computer equipment | 50% declining balance |
| Furniture and equipment | 20% declining balance |
| Software license | Straight line over the 15 year contract life |
| Leasehold improvements | Over the term of the leases (1.1 and 3 years) |
| Computer software | Straight line over 3 years |

### e) Revenue recognition

Revenue from the sale of dealer management system software is recognized upon the completion of installation and setup. Revenue from equipment sales and installation is recognized in the period in which the installation is complete or, in the event installation is not required, when the equipment is shipped. Licensing fees, user fees, support fees, and data management fees from the dealer management system are recognized as the services are provided. Revenue from website development is recognized in the period in which the services are performed. Revenue from reverse publishing is recognized in the month in which the services are provided.

Payments received in advance of providing the service or delivering the product is recorded as unearned revenue and is included in accounts payable and accrued liabilities at August 31, 2003 and 2002.

### f) Software development costs

Costs of developing, updating and maintaining internally developed computer software and websites are expensed as incurred. The cost of acquiring third party software is capitalized and amortized over its estimated useful life.

### g) Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, the Company records income taxes to give effect to temporary differences between the carrying amount and the tax bases of the Company's assets and liabilities. Temporary differences arise when the realization of an asset or the settlement of a liability would give rise to either an increase or decrease in the Company's income taxes payable for the year or for a later period. Future income taxes are recorded using substantively enacted income tax rates that are expected to apply when the future tax liability is settled or the future tax asset is realized. When necessary, valuation allowances are established to reduce future income tax assets to the amount expected to be realized. Income tax expense is the tax payable for the period and the change during the period in future income tax assets and liabilities.

### h) Stock-based compensation plan

Effective September 1, 2002, the Company prospectively adopted the new Canadian Institute of Chartered Accountants standard for stock-based compensation. The new standard requires that stock-based payments to non-employees, direct awards of stock and awards that call for settlement in cash or other assets be accounted for using the fair value method of accounting. The fair value method is encouraged for other stock-based compensation plans, but other methods of accounting, such as the intrinsic value based method, are permitted. Under the fair value method, compensation expense is measured at the grant date and recognized over the service period. Under the intrinsic value based method, compensation expense is determined as the difference between the fair value and the exercise price of the equity instruments granted. If the intrinsic value based method is used, pro forma disclosure is made of earnings or losses and the related per share amounts as if the fair value method had been used. The Company has elected to use the intrinsic value based method of accounting for options issued under its stock option plan. Accordingly, no compensation expense has been recognized for this plan (see note 9).

### i) Loss per share

Basic loss per share is calculated using the weighted average number of shares outstanding. Diluted loss per share is calculated in accordance with the treasury stock method. The effect on loss per share of the exercise of options and warrants and the conversion of debentures is anti-dilutive.

The weighted average shares outstanding for the year ended August 31, 2003 was 21,620,185 (2002 - 20,666,760).

### j) Foreign currency translation

The Company's foreign operations are considered integrated and are translated into Canadian dollars using the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the dates the assets were acquired or liabilities were assumed. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. The resulting exchange gains or losses on these items are reflected in net loss in the period incurred.

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# Notes to Consolidated Financial Statements

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## 3. CAPITAL ASSETS

| | 2003 | | |
|---|---|---|---|
| | Cost $ | Accumulated Depreciation and Amortization $ | Net Book Value $ |
| Computer equipment | **1,059,322** | **923,995** | **135,327** |
| Furniture and equipment | **363,489** | **191,907** | **171,582** |
| Software license | **2,000,000** | **1,908,276** | **91,724** |
| Leasehold improvements | **45,256** | **28,914** | **16,342** |
| Computer software | **2,289,791** | **2,286,080** | **3,711** |
| | **5,757,858** | **5,339,172** | **418,686** |

| | 2002 | | |
|---|---|---|---|
| | Cost $ | Accumulated Depreciation and Amortization $ | Net Book Value $ |
| Computer equipment | 1,050,831 | 879,284 | 171,547 |
| Furniture and equipment | 380,989 | 161,511 | 219,478 |
| Software license | 2,000,000 | 1,900,000 | 100,000 |
| Leasehold improvements | 161,014 | 136,588 | 24,426 |
| Computer software | 2,284,534 | 2,272,035 | 12,499 |
| | 5,877,368 | 5,349,418 | 527,950 |

Depreciation and amortization for the year ended August 31, 2002 included $595,990 which represented a write-down of certain capital assets to their estimated net recoverable amount; no such write-down was recorded during fiscal 2003.

Capital assets include assets under capital leases of approximately $110,635 (accumulated depreciation of $50,880) as at August 31, 2003.

## 4. DUE TO SHAREHOLDERS

The Due to shareholders balance at August 31, 2002 was comprised of payments, discounted at an imputed rate of 15%, due to the previous Conxsys Inc. shareholders, arising from the acquisition of Conxsys, which company has since been wound up into Megawheels. On February 20, 2002, the original Share Purchase Agreement for Conxsys was amended with the signing of a Memorandum of Settlement, which reduced the total amount due with payments due over the period ending February 15, 2003. The reduction of the amount due, in the amount of $122,522 was included in other income during fiscal 2002.

## 5. CONVERTIBLE DEBENTURES/NOTES

| | Principal Amount $ | Debt Component $ | Equity Component $ |
|---|---|---|---|
| Balance, August 31, 2001 | 1,250,000 | 1,152,359 | 145,000 |
| Convertible promissory notes issued (a) | 636,200 | 562,200 | 74,000 |
| Issue costs | – | – | (897) |
| Notes converted (b) | (636,200) | (580,186) | (73,103) |
| Convertible promissory note issued (c) | 642,600 | 568,000 | 74,600 |
| Related accretion during the period | – | 153,149 | – |
| Balance, August 31, 2002 | 1,892,600 | 1,855,522 | 219,600 |
| Convertible promissory notes issued (d) | 387,060 | 342,075 | 44,985 |
| Convertible promissory notes issued (e) | 368,200 | 325,400 | 42,800 |
| Convertible promissory notes issued (f) | 368,772 | 325,900 | 42,872 |
| Debentures converted (g) | (1,000,000) | (1,000,000) | (116,000) |
| Notes converted (h) | (1,397,860) | (1,154,946) | (162,385) |
| Convertible promissory notes issued (i) | 400,800 | 355,700 | 45,100 |
| Notes converted (j) | (400,800) | (356,823) | (45,100) |
| Related accretion during the period | – | 82,864 | – |
| Unrealized foreign exchange gain | – | (205,445) | – |
| Balance, August 31, 2003 | 618,772 | 570,247 | 71,872 |

(a) On November 14 and December 21, 2001, the Company issued convertible promissory notes for a total principal amount of $636,200 (US$400,000) maturing one year after the date of issue and bearing interest at 10% per annum. As a condition of the financing, the Company agreed to consolidate its common shares on the basis of one consolidated share for two existing common shares (see note 8). The notes were convertible into 5,301,667 series C convertible preferred shares and 5,301,667 warrants to purchase series C shares at $0.12 (the "series C warrants") after giving effect to the one-for-two consolidation. The series C warrants are exercisable one year from the date of issuance. The debt component of these notes was recorded at $562,200 and the discount from the amount payable at maturity is accreted over the terms of the notes. The conversion options, valued at a total of $74,000, were recorded as contributed surplus.

(b) On February 28, 2002, the convertible promissory notes referred to in (a) above were converted into 5,301,667 series C convertible preferred shares and 5,301,667 series C warrants. In addition, the holder agreed to accept 127,813 series C convertible preferred shares and 127,813 series C warrants in satisfaction of accrued interest of $15,338 (see note 8). The series C warrants are exercisable until February 27, 2003.

(c) On February 27, 2002, the Company issued a $642,600 (US$400,000) one year 10% per annum convertible promissory note maturing on February 27, 2003. The note is convertible into 5,355,000 series C convertible preferred shares of the Company and 5,355,000 series C warrants to purchase series C shares at $0.12. The warrants are exercisable one year from the date of issuance. The note may be repaid by the Company at any time prior to maturity with the consent of the holder. The debt component of the note was recorded at $568,000 and the discount from the amount payable at maturity is accreted over the term of the note. The conversion option, valued at $74,600 was recorded as contributed surplus.

(d) On December 9, 2002 and January 10, 2003, the Company issued convertible promissory notes for a total principal amount of $387,060 (US$250,000) maturing one year after the date of issue and bearing interest at 10% per annum. The notes are convertible into 3,225,500 Series C preferred shares of the Company at the option of the holder. The note holder also received 3,225,500 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at anytime prior to August 15, 2004. The notes may be repaid at any time prior to maturity with the consent of the holder. The debt component of these notes was recorded at $342,075 and the discount from the amount payable at maturity is accreted over the terms of the notes. The conversion option, valued at a total of $44,985, was recorded as contributed surplus.

(e) On February 28, 2003, the Company issued a convertible promissory note for a total principal amount of $368,200 (US$250,000) maturing one year after the date of issue and bearing interest at 10% per annum. The note is convertible into 3,068,333 Series C preferred shares of the Company at the option of the holder. The note holder also received 3,068,333 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at anytime prior to August 15, 2004. The note may be repaid at any time prior to maturity with the consent of the holder. The debt component of these notes was recorded at $325,400 and the discount from the amount payable at maturity is accreted over the terms of the notes. The conversion option, valued at a total of $42,800, was recorded as contributed surplus.

(f) On April 24, 2003 the Company issued convertible promissory notes for a total principal amount of $368,772 (US$250,000) maturing one year after the date of issue and bearing interest at 10% per annum. The notes are convertible into 3,073,098 Series C preferred shares of the Company at the option of the holders. The note holders also received 3,073,098 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at anytime prior to August 15, 2004. The debt component of these notes was recorded at $325,900 and the discount from the amount payable at maturity is accreted over the terms of the notes. The conversion option, valued at a total of $42,872, was recorded as contributed surplus.

(g) On June 4, 2003, convertible debentures for a total principal amount of $1,000,000 were converted into 4,000,000 common shares (see note 8). As the original agreement had provided for conversion into 2,000,000 common shares (post-consolidation), the additional 2,000,000 shares issued to induce the conversion were measured at fair market value and have been recorded in the accompanying financial statements as a loss on settlement of debt in the amount of $50,000 with an offsetting credit to common share capital. In exchange for the waiver by the Company of all advertising and promotional obligations, the debentureholder agreed to waive the payment of accrued interest on these debentures up to the date of conversion, in the amount of $225,767. The waiver of interest has been recorded in the accompanying financial statements as a reduction of interest expense in the year ended August 31, 2003.

(h) On June 18, 2003, the convertible promissory notes referred to in (c), (d) and (e) above were converted into 10,022,249 series C convertible preferred shares. The note holder agreed to accept 2,500,000 warrants rather than the 5,355,000 warrants referred to in note (c) above. In addition, the holder agreed to accept 850,618 series C convertible preferred shares in satisfaction of accrued interest of $100,038 (see note 8). The series C warrants are exercisable until August 15, 2004.

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# Notes to Consolidated Financial Statements

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(i) Between May, 2003 and August, 2003 the Company entered into agreements to provide for the issuance of additional convertible promissory notes for a total principal amount of $400,800. The notes are convertible into approximately 3,340,000 Series C preferred shares of the Company at the option of the holders. The note holders will also receive approximately 3,340,000 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at any time until one year after the date on which the offering is completed. The debt component of these notes was recorded at $355,700, and the discount from the amount payable at maturity is accreted over the terms of the notes. The conversion option, valued at a total of $45,100, was recorded as contributed surplus.

(j) Between May, 2003 and August, 2003, the convertible promissory notes referred to in (i) above were converted into 3,340,000 series C convertible preferred shares (see note 8).

## 6. RELATED PARTY TRANSACTIONS

The Company entered into transactions in the normal course of business with Studon Business Solutions Inc. and Studon Electric Controls Inc. (collectively "Studon"). Certain shareholders of Studon hold non-controlling interests in Megawheels, and the Company and Studon have a common director. During the year ended August 31, 2003, an amount due from Studon for $31,959 was applied against charges incurred by Studon on behalf of the Company for an office lease guarantee, with an offsetting charge to general and administrative expenses. Other transactions with Studon, which were subject to normal credit terms and recorded at the exchange amounts, were as follows:

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| Capital assets purchased(sold) | (5,000) | 13,509 |
| General and administrative | – | 65,875 |

Trade accounts receivable includes $5,350 payable by Studon at August 31, 2003.

## 7. CAPITAL LEASE OBLIGATIONS

The following is a schedule of future minimum lease payments under capital leases expiring in October 2006, together with the balance of the capital lease obligations;

| | $ |
|---|---|
| Year ended August 31,2004 | 45,638 |
| 2005 | 32,665 |
| 2006 | 11,410 |
| 2007 | 635 |
| | 90,348 |
| Less amount representing interest at rates varying between 13.6% and 18.9 % | 13,915 |
| | 76,433 |
| Less Current portion | 36,162 |
| | 40,271 |

## 8. SHARE CAPITAL

Authorized

An unlimited number of common voting shares without nominal or par value.

An unlimited number of voting preferred shares, issued in series, of which 15,000,000 Series A convertible, 15,000,000 Series B convertible shares, and 78,000,000 (August 31, 2002 – 15,000,000) Series C convertible preferred shares are authorized.

The preferred shares are entitled to preference over the common shares with respect to the payment of dividends and the distribution of assets. Each Series B share carries the right to one-half a vote and is convertible at any time, at the option of the holder, into one-half of a common share. Each Series C share carries the right to vote and is convertible at any time, at the option of the holder, into one common share.

Issued

| **Common Shares** | **Number** | **$** |
|---|---|---|
| Common shares outstanding, August 31, 2001 | 41,333,513 | 21,518,852 |
| Effect of share consolidation (net of consolidation costs of $3,500) (b) | (20,666,753) | (3,500) |
| Common shares outstanding, August 31, 2002 | 20,666,760 | 21,515,352 |
| Issued on conversion of debentures (note 5(g)) | 4,000,000 | 1,166,000 |
| **Common shares outstanding, August 31, 2003 (a)** | **24,666,760** | **22,681,352** |

| **Series B Preferred shares** | **Number** | **$** |
|---|---|---|
| **Series B preferred shares outstanding, August 31, 2002 and 2003 (f)** | **13,444,547** | **2,555,831** |

| **Series C Preferred shares** | **Number** | **$** |
|---|---|---|
| Series C preferred shares outstanding, August 31, 2001 | – | – |
| Series C shares issued on conversion of notes (note 5(b)) | 5,301,667 | 653,289 |
| Series C shares issued in settlement of accrued interest (note 5(b)) | 127,813 | 15,338 |
| Series C shares to be issued for cash (c) | 3,577,542 | 424,305 |
| Series C preferred shares outstanding, August 31, 2002 (f) | 9,007,022 | 1,092,932 |
| Series C shares to be issued (c) | (3,577,542) | (424,305) |
| Series C shares issued (c) | 3,577,542 | 424,305 |
| Series C shares issued for cash (d) | 317,958 | 38,155 |
| Series C shares issued for cash (e) | 3,305,000 | 391,600 |
| Issue costs | – | (18,432) |
| Series C shares issued on conversion of notes (note 5(h)) | 10,022,249 | 1,317,331 |
| Series C shares issued in settlement of accrued interest (note 5(h)) | 850,618 | 100,038 |
| Series C shares issued on conversion of notes (note 5(j)) | 3,340,000 | 401,923 |
| **Series C preferred shares outstanding, August 31, 2003** | **26,842,847** | **3,323,547** |

| **Series C Warrants** | **Number** | **$** |
|---|---|---|
| Series C warrants outstanding, August 31, 2001 | – | – |
| Series C warrants issued upon conversion of notes (note 5(a)) | 5,301,667 | – |
| Series C warrants issued in settlement of accrued interest (note 5(b)) | 127,813 | – |
| Series C Warrants outstanding, August 31, 2002 | 5,429,480 | – |
| Series C Warrants expired | (5,429,480) | – |
| Series C Warrants issued upon conversion of notes | 11,866,931 | – |
| Series C Warrants to be issued on completion of offering (note 5(i)) | 3,340,000 | – |
| **Series C Warrants outstanding, August 31, 2003** | **15,206,931** | – |

| **Common Share Warrants** | **Number** | **$** |
|---|---|---|
| Common share warrants issued (c) | 3,577,542 | – |
| Common shares warrants issued (d) | 317,958 | – |
| Common share warrants issued (e) | 3,305,000 | – |
| **Common share Warrants outstanding, August 31, 2003** | | **7,200,500** |
| **Total Share Capital at August 31, 2003** | | **28,560,730** |

Common Shares

(a) At August 31, 2003 there are 1,703,510 common shares held in escrow under an agreement dated May 18, 1999, pursuant to the requirements of the Alberta Securities Commission and the former Canadian Venture Exchange in connection with the reverse takeover of Megawheels. These shares are releasable based on the Company's financial performance.

(b) As a condition of the financing described in note 5(a), and effective on February 28, 2002, the issued and outstanding common shares of the Company were consolidated on a one-for-two basis, with shareholders holding an odd number of shares receiving full share equivalents.

Preferred Shares

(c) In July, 2002, the Company entered into an agreement to raise US$1,000,000 of financing over a period of nine months subject to various conditions, including a co-investment by management totalling US$50,000 and an additional US$500,000 from other investors and conversion into equity of the $1,000,000 debenture described in note 5(g). In August, 2002, in connection with this financing, total proceeds of $429,305 (US$275,000) were received, before issue costs of $5,000, for which the Company agreed to issue 3,577,542 Series C preferred shares and 3,577,542 common share purchase warrants. Each warrant entitles the holder to purchase one common share at $0.12 at any time until one year after the date of issue. At August 31, 2002 the proceeds were received but the shares and warrants were still in the process of being issued. During the year ending August 31, 2003, the shares and warrants were issued.

(d) On September 20, 2002, a portion of the co-investment by management mentioned in (c) above was received in the amount of $38,155. In return, the Company issued 317,958 Series C preferred shares and 317,958 common share purchase warrants.

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(e) On October 10, 2002, $396,600 (US$250,000) was received, before issue costs of $5,000, as part of the agreement mentioned in (c) above. In return, the Company issued 3,305,000 Series C preferred shares and 3,305,000 common share purchase warrants.

(f) The provisions of certain of the series B and C preferred shares included, amongst others, that the holder may require the Company to re-purchase the shares at three times their issue price if the Company has not become listed on the Toronto Stock Exchange or Nasdaq by November 14, 2003. During the year ended August 31, 2003 the holders of these notes irrevocably waived this retraction privilege.

## 9. STOCK OPTION PLAN

The Company has a stock option plan available to officers, employees, directors and other persons providing ongoing services to the Company. Under the plan, the number of common shares reserved for issuance must be a fixed number that is not greater than 20% of the issued and outstanding common shares, including issued and outstanding convertible Series B and C preferred shares. The number of common shares reserved for issuance was fixed by the shareholders on February 21, 2003 at 8,003,804 shares. The shareholders also adopted resolutions that authorized that the number of options issued under the Stock Option Plan to the aggregate of insiders, options that carry the rights to purchase a number of common shares equal to more than 10% of the issued shares of the Company. The following is a continuity of stock options outstanding for which shares have been reserved (after giving effect to a one-for-two consolidation of the issued common shares of the Company):

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | Options Outstanding (#) | Weighted-Average Exercise Price $ | Options Outstanding (#) | Weighted-Average Exercise Price $ |
| Opening | 4,571,250 | 0.34 | 1,726,750 | 1.07 |
| Granted | 3,800,000 | 0.12 | 3,820,000 | 0.12 |
| Exercised | – | – | – | – |
| Cancelled | (1,540,500) | 0.68 | (975,500) | 0.79 |
| Closing | 6,830,750 | 0.14 | 4,571,250 | 0.34 |

The following summarizes information about stock options outstanding at August 31, 2003:

| Exercise Prices $ | Number outstanding | Weighted-Average Remaining Contractual Life (years) | Weighted-Average Exercise Price $ | Number exercisable | Weighted-Average Exercise Price $ |
|---|---|---|---|---|---|
| 0.12 | 6,414,999 | 4.1 | 0.12 | 2,128,332 | 0.12 |
| 0.40 | 372,000 | 2.6 | 0.40 | 372,000 | 0.40 |
| 0.80 | 43,751 | 0.2 | 0.80 | 43,751 | 0.80 |
| | 6,830,750 | 3.9 | 0.14 | 2,544,083 | 0.17 |

The expiry dates of these options range from October 30, 2003 to July 24, 2008.

At August 31, 2003, of the 6,830,750 stock options granted, 2,544,083 were fully vested. The remaining 4,286,667 stock options will vest as follows:

| Vesting Date | Number of shares vesting |
|---|---|
| February 2004 | 536,667 |
| April 2004 | 273,333 |
| July 2004 | 136,667 |
| August 2004 | 13,333 |
| February 2005 | 536,667 |
| July 2005 | 130,000 |
| Performance based | 2,660,000 |
| | 4,286,667 |

The Company accounts for stock options based on the intrinsic value at the date of grant. Accordingly, no compensation cost has been recognized for this plan. The following pro forma financial information presents the net loss and loss per common share had the Company elected to recognize compensation expense based on the estimated fair value of the options on the grant date in accordance with the fair value method of accounting for the stock options. The pro forma disclosure omits the effect of awards granted before the years beginning September 1, 2002.

| | For the year ended August 31, 2003 $ |
|---|---|
| Net loss for the year as reported | (1,549,064) |
| Compensation expense | (31,165) |
| Pro forma net loss | (1,580,229) |
| Basic and diluted loss per share as reported | ($0.07) |
| Pro forma basic and diluted loss per share | ($0.07) |

During the year ending August 31, 2003, the Company granted 3,550,000 stock options and re-issued 250,000 stock options, with an exercise price of $0.12 per share, as per the Company's Stock Option Plan. The weighted average fair value of the stock options granted was $0.06 per share. The Company used the Black-Scholes option pricing model to estimate the fair value of the options at each grant date with the following assumptions:

| | |
|---|---|
| Expected dividend yield | 0.0% |
| Volatility in the price of the Company's shares | 113.4% |
| Risk-free interest rate | 3.31% |
| Expected life | 3 years |

## 10. NET CHANGE IN NON-CASH WORKING CAPITAL

| | 2003 $ | 2002 $ |
|---|---|---|
| Trade accounts receivable | **(152,529)** | 67,516 |
| Other accounts receivable | – | 75,285 |
| Inventory | **3,261** | (5,804) |
| Prepaid expenses and deferred charges | **29,531** | 352,676 |
| Accounts payable and accrued liabilities | **(362,032)** | (85,060) |
| Due to shareholders | **(57,460)** | (130,368) |
| | **(539,229)** | 274,245 |

## 11. INCOME TAXES

The Company's computation of income tax expense is as follows:

| | 2003 $ | 2002 $ |
|---|---|---|
| Expected income tax recovery at 37.63% (August 31, 2002 – 39%) | **(582,913)** | (1,561,023) |
| Decrease(increase) in tax benefit resulting from: | | |
| Future tax asset valuation allowance | **383,112** | 1,435,279 |
| (Higher)lower effective foreign tax rates | **(1,251)** | 52,934 |
| Non-deductible expenses | **60,320** | 72,810 |
| Reduction in temporary differences from tax reassessment | **182,096** | – |
| Non-taxable portion of capital gains | **(41,364)** | – |
| Reduction in future income tax assets due to tax rate changes | **167,117** | 1,587,736 |
| Reduction in valuation allowance as a result of tax rate changes | **(167,117)** | (1,587,736) |
| Income tax recovery | – | – |

The components of the Company's future tax assets and liabilities are as follows:

| | 2003 $ | 2002 $ |
|---|---|---|
| Future tax assets: | | |
| Net operating loss carryforwards | **5,733,608** | 7,229,106 |
| Cumulative eligible capital | **4,190** | 43,904 |
| Excess undepreciated capital cost over net book value | **3,608,810** | 1,837,545 |
| Share and warrant issue costs | **105,462** | 324,365 |
| Total future income tax assets | **9,452,070** | 9,434,920 |
| Valuation allowance | **(9,452,070)** | (9,434,920) |
| Net future income tax assets | – | – |

The Company has provided a valuation allowance for the full amount of net future income tax assets in light of its history of operating losses since its inception.
At August 31, 2003, the Company has non-capital losses carried forward for Canadian and International income tax purposes and the expiry of the Canadian losses are as follows:

| | $ |
|---|---|
| 2006 | 690,524 |
| 2007 | 6,498,320 |
| 2008 | 5,501,756 |
| 2009 | 1,695,625 |
| | 14,386,225 |

The losses for the United States operations of approximately $488,000 expire within 19 years, and the losses for the United Kingdom operations of approximately $1,809,000 may be carried forward indefinitely.

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## 12. COMMITMENTS

The Company has commitments for vehicle operating leases and leased premises. The lease terms expire on dates ranging from September 2003 to December 2007. The lease commitments are as follows:

| | $ |
|---|---|
| Year ended August 31, 2004 | 204,644 |
| 2005 | 118,768 |
| 2006 | 4,927 |
| 2007 | 1,642 |
| | 329,981 |

## 13. FINANCIAL INSTRUMENTS

Financial instruments consist of cash and cash equivalents, trade accounts receivable, prepaid deposits, due from related companies, accounts payable and accrued liabilities, due to shareholders, and capital lease obligations. There is no material difference between the carrying value of these instruments and their fair value. The fair value of convertible debentures/notes is not readily determinable. Information about the terms, conditions and characteristics of this debt is presented in note 5.

The Company does not have a concentration of credit risk due to its wide customer and supplier base. The Company's activities involve purchases and sales of certain products and services that are denominated in foreign currencies. These activities result in an exposure to the fluctuations in those foreign currencies.

## 14. SEGMENT INFORMATION

The Company's activities are conducted in one operating segment and are carried out in four geographic segments consisting of Canada, United States, United Kingdom, and Ireland. All geographic segments derive revenues from reverse publishing and technology solutions that link the media and automotive sectors.

**2003**

| | Canada $ | United States $ | United Kingdom $ | Ireland $ | Total $ |
|---|---|---|---|---|---|
| Revenue | **1,692,960** | **108,049** | **283,637** | **314,438** | **2,399,084** |
| Capital assets | **413,923** | – | **2,550** | **2,213** | **418,686** |

**2002**

| | Canada $ | United States $ | United Kingdom $ | Ireland $ | Total $ |
|---|---|---|---|---|---|
| Revenue | 2,198,626 | 77,636 | 649,926 | – | 2,926,188 |
| Capital assets | 502,845 | – | 25,105 | – | 527,950 |

## 15. SUBSEQUENT EVENTS

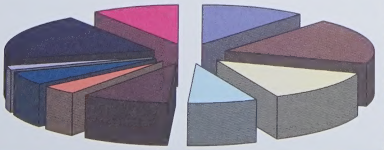
During September, 2003, the Company entered into agreements for the issuance of additional convertible promissory notes for a total principal amount of $122,400. The notes are convertible into approximately 1,020,000 Series C Preferred shares of the Company at the option of the holders. The noteholders will also receive approximately 1,020,000 Series C warrants to purchase Series C shares of the Company at $0.12 per share. The warrants are exercisable at any time until one year after the date on which the offering is completed.

## 16. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the current year's presentation.

# Drive: the flexible solution

Megawheels Drive provides a configurable architecture enabling a variety of low cost solutions to dealerships of all sizes. The ease of customization and installation affords Drive customers an alternative in the market place populated by costly Dealer Management Systems. The flexibility and exceptional customer support has made Drive a favorable choice among import automotive retailers. Graph illustrates Drive customer base by Manufacturer.




# Megawheels Timeline

## 1995

Megawheels opens doors for business as Rapid-Exchange

## 1996

Megawheels begins serving content online as auto-search.com providing consumer search engine and dealer website

## 1997

Megawheels changes their brand to Megawheels.com

## 1998

Megawheels wins Mecklermedia's Internet World Impact award for "Changing the Way People Buy"

Westview Multimedia Inc. was listed on the Alberta Stock Exchange as a junior capital pool company in October which then went on to become Megawheels.com Inc.

## 1999


Megawheels published the first Megawheels Magazine, a publication containing information from the Website in Calgary, Edmonton, Vancouver, Toronto, and Ottawa

Megawheels partners with The Globe and Mail (Canada's National Newspaper©) in Calgary, Edmonton, Vancouver to produce GlobeMegawheels weekly auto section

## 2000


Megawheels extended its GlobeMegawheels print supplement to Toronto and Ottawa and Victoria

Megawheels enter the Dealer Management System business with the acquisition of Conxsys

Megawheels ranked #14 in the "Top 25 e-business in Canada" by Bain & Company and The Globe and Mail

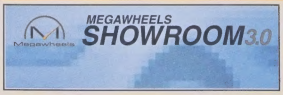
## 2001

Megawheels partners with The Irish Times to build IrishTimesMotors.com

## 2002

Megawheels change their name to Megawheels Technologies Inc. New focus on Technologies and media platform software

Megawheels produces auto insert for The Irish Times




The Microsoft.Net next generation Megawheels Showroom 3.0 and Media platform was launched with debut of the Canadaeast.com auto portal and newspaper insert for Brunswick News CanadaEast Wheels Auto section

## 2003

Megawheels launched Showroom version SE providing enhanced features for greater classified advertising integration

Megawheels partners with New York Daily News to provide Technology for Auto Market

Megawheels becomes partners with Halifax Daily News and produces Automotion


Megawheels returns home to Alberta and partners with Red Deer Express to launch a website for the Central Alberta automotive community.

Introduction of Property and Advertising Management software (Megawheels ShowSuite) to the Irish marketplace along with the launch of IrishTimesProperty.com

# Changing of the Guard

## Megawheels enhances their Marketing Operations

In the past year, Megawheels has made is presence known in the marketplace by attending numerous trade shows and conferences around the world.

In May they had a very successful stand at the World Association of Newspapers annual conference in Dublin, Ireland. The show was attended by the key players from the worlds media industry and their presence was noted by many of these people.

The Las Vegas NEXPO held by the Newspaper Association of America (NAA) in July, once again saw Megawheels at the centre of attention and they met many new contacts.

Their presence will also be felt at the Suburban Newspaper Association show in Philadelphia in November and IFPA show in Florida also in November.

Throughout 2002/3, they have continued to develop their Marketing strategy with the redesign of their website, branding and sales material. As they have diversified from the automotive industry, they have been able to create a more generic look and feel for the company.

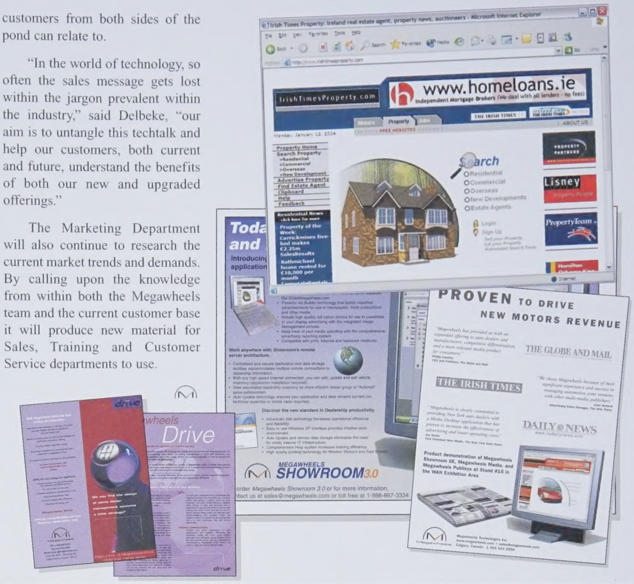
Using the in-house expertise, they have concentrated on visualising their presentation material so that they can better express their message to their customers. "The beauty of faster, more compact technology is the ease in which presentation material can be taken to the clients," said Matthew Delbeke, Megawheels Marketing Director, "we have cut our costs dramatically by keeping design in-house rather than outsourcing, the results are also noticeably better so it is a win win situation."

In the coming year, Megawheels is ramping up it's Marketing activity in a proactive bid to make its product range more transparent, easier to understand and therefore easier to promote, sell and implement.

They have internally established a team of people with proven track records in this field, with both European and Canadian knowledge sets. With this combination, they will be able to produce material that customers from both sides of the pond can relate to.

"In the world of technology, so often the sales message gets lost within the jargon prevalent within the industry," said Delbeke, "our aim is to untangle this techtalk and help our customers, both current and future, understand the benefits of both our new and upgraded offerings."

The Marketing Department will also continue to research the current market trends and demands. By calling upon the knowledge from within both the Megawheels team and the current customer base it will produce new material for Sales, Training and Customer Service departments to use.




## Megawheels Products and Services

### Automotive

#### Megawheels Drive DMS

Drive is a modular Dealer Management System that allows Dealers to run their Inventory, Accounts and payroll, Service and parts, CRM and Marketing, Prospecting, Communications and F&I systems in parallel. Certified by many Manufacturers for use within their dealers, the system streamlines the car sales process at all stages.

Using web enabled technology on the latest version, the one time data entry of a vehicle facilitates all functionality during its life within the sales and after-sales process. It enables a dealer to keep in contact with the consumer at all times and allows for seamless integration between all departments.

The key to the success of the Drive product is its simplicity, it is easy to learn and easy to use for individuals which promotes buy in from employees. The ability to design it to the customers bespoke requirements also gives the flexibility not seen in many competing products.

#### Branded Vehicle Search Site

The Megawheels Automotive web services provided to our media partners around the world offer them a fully integrated consumer website with all functionality conducent to acquiring a high level of content, being a self contained revenue generator for the media partner and also offering exceptional levels of functionality to the consumer.

The web systems, offer a high level of functionality such as a duel level search engine, saved searches and clipboard, customer profiling and log in, payment engine for private ads, links to print via short codes, Banner ads and tiles plus an extremely user friendly layout.

Integrating with the current website of the media partner, the Megawheels web services offer the consumer a seamless experience while searching for a vehicle as well as offering the media partner revenue generating opportunity through both private and commercial advertising.

#### Showroom SE

This is a Dealer based inventory management systems that also allows submission to web and print.

Using the very latest Microsoft .Net platform, these systems are, once again, easy to learn and use to ensure employee buy in. Their functionality includes, inventory and image management, full reporting, marketing material design and production, media management and data export.

"The use of Microsoft .Net as a platform to build our products has meant huge time savings and efficiencies," said Robert Jolly, COO Megawheels, "previously we have spent weeks implementing new systems which now takes a matter of days. This has made us more streamlined as a company"

An integral part of the Showroom product, the Media Manager has enabled our media partners to concentrate on selling as opposed to ordertaking and copychange. The system empowers the Dealer to produce their own classified adverts, add images, check the layout and also the cost before submission to print.

The key, once again, to the success of Media Manager as part of the Showroom product has been it's simplicity for the user. So often, advertising has been a burden to the dealers and often left until the last minute of deadline. This has lead to mistakes or missed deadlines, resulting in frustration. "By empowering the dealers to submit their own advertisements," says Jolly, "we have helped to increase advertising revenues, increase efficiencies and thus reduce costs for our media partners."

#### Automotive Publisys

The job of turning the submitted ads from the Dealers into the classified sections within the papers is aided hugely by the Publisys systems and services offered by Megawheels.

By interpreting the newspapers layout, Publisys (Publication Systems) provides data blending capabilities for newspapers classified systems, web submission and private classifieds information to create an ordered classified section in a time critical manner ready for print.

### Real Estate

#### Branded Property Search Site

The Real Estate web services offered by Megawheels give our media partners a fully functional Real Estate website that integrates with their current Newspaper and online systems

With the end user in mind at all times the site is simple to use and offers an extremely effective search and store service as well as marketing profiling potential for all users. Allowing users to search for private, commercial, overseas and new properties means that it caters for all potential market places and broadens the appeal for the media partners readers.

With the banner and tile ad space, the revenue generation potential to the media partner is greatly enhanced and the look of the site, bright and appealing.

The quick code search system integrates the site with the printed version and allows readers to find detailed property specification from smaller printed ads.

#### Showsuite

Showsuite is the Estate Agent based property inventory management system that empowers the agent to add, amend and delete properties with images for the online content as well as producing marketing literature in-house for distribution to the consumer.

The software integrates the Agents with the Media partner and as well as a relationship builder, it also offers both parties huge efficiencies with regard to ad submission and web content.

The process of submitting ads to the media partner for an Agent can be time consuming, Megawheels Media Manager which sits within the Showsuite product, makes this process more efficient and error free. From the Media partners point of view, it reduces time and allows their representatives to concentrate on selling as opposed to copy and ordertaking.

Effective for both classified and display advertising, the agent is empowered to build their ads look and feel, critique the ad spend, set time lines and even submit to publications other than that of the media partner.

This is key to strengthening the relationship between the Papers and Agents and makes the whole process more efficient.

#### Real Estate Publisys

Publisys is the system and service that Megawheels offers, building and submitting to the media partner, the supplement within the Newspaper.

Taking the papers look, feel and printing constraints as well as incorporating editorial and manually submitted ads from traditional systems, the service is a time critical media production system that takes the weight off the media partner to produce their supplements.

# Corporate Information

**BOARD OF DIRECTORS**

**Christopher Bulger, CFA, MBA**
Chairman and CEO
Megawheels Technologies Inc.

**John Byrne, BComm, FCA**
Director
Megawheels Technologies Inc.

**Phillip Crawley**
Publisher and CEO
The Globe and Mail

**Martin Hilsenteger, CA**
President
Megawheels Technologies Inc.

**James Robert McPherson**
Partner
McPherson L'Hirondelle
Associates

**Chuck Walker**
President and CEO
The Walker Group

**MANAGEMENT TEAM**

**Christopher Bulger, CFA, MBA**
Chairman and CEO

**Martin Hilsenteger, CA**
President

**Robert F. Jolly**
Chief Operating Officer

**Kathy Cherniak**
Director, Client Services

**MGT TEAM (Continued)**

**Matt Delbeke**
Director, Sales and Marketing

**Andy Feltmate**
General Manager, Drive

**Mark Franssen**
Director, Information Technology

**Danielle Leger, CMA**
Corporate Controller

**REGISTRAR AND TRANSFER AGENT**

**Computershare Trust Company of Canada**
600, 530 – 8th Ave. S.W.
Calgary, AB Canada T2P 3S8

**AUDITORS**

**Ernst & Young LLP**
**Chartered Accountants**
1000, 440 – 2nd Ave. S.W.
Calgary, AB Canada T2P 5E9

**LAWYERS**

**McCarthy Tetrault**
**Barristers & Solicitors**
Suite 3300, 421 7th Ave. S.W.
Calgary, AB Canada T2P 4K9

**CORPORATE SECRETARY**

**Peter Stone**
**Barrister & Solicitor**
1922 Bowness Road N.W.
Calgary, AB Canada T2N 3K6

## Share Information

| | |
|---|---|
| As of December 31, 2003 | |
| Shares Issued and Outstanding | 60,261,884 |
| Fully Diluted | 88,974,413 |
| 52 Week Hi Low | \$0.15 - \$0.06 |
| Recent Price (December 31, 2003) | \$0.12 |
| Market Cap | \$10,676,930 |

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Fax: 403-543-2995
Email: investor@megawheels.com
Website: www.megawheels.com


# Megawheels 2004 Preview

## Milestones: First quarter brings new partnership

**Q1 2004 Ended November 30, 2004**

- Q1 2004 operating results also evidenced a 50% reduction in sequential quarterly cash burn to (\$168,242) from (\$339,035) in Q4, 2003. There was a 43% improvement in sequential quarterly EBITDA loss to (\$208,314) from (\$363,878) in Q4 2003. Operational EBITDA, defined as EBITDA less discretionary R&D, improved to (\$90,545) from (\$184,257) for sequential improvement of 51% in the relative profitability of the underlying business net of R&D investment.
- Q1 2004 recorded an 11% sequential quarterly increase in revenues to \$627,895 from \$564,170 in Q4 2003. The quarterly revenue growth was primarily the result of increased long term contracted licensing revenues from the development of a real estate portal for The Irish Times, completed upgrades to DMS installations and growth in the number of auto dealers using the media platform.
- Introduction of Property and Advertising Management software, Megawheels Showsuite, to the Irish marketplace along with the launch of IrishTimesProperty.com. By using core framework technologies, this project was developed and deployed in less than 4 months. The launch of IrishTimesProperty.com exceeded expectations of The Irish Times, their estate agents and visitors to The Irish Times site. The first quarter of operations has experienced increase growth and consumer acceptance.
- Commercial renewal with Bell GlobeMedia was completed for GlobeMegawheels following their Cdn\$1 million debt to equity conversion in the previous quarter. Megawheels has attempted to strengthen its relationship and increase operational efficiencies with The Globe and Mail (Canada's National Newspaper©) by implementing an on-site client services and a support representative.
- Third party research by Cochran & Company provided comparative statistics within the Greater Toronto Area that illustrate the growth of GlobeMegawheels, which has a achieved 23% relative market share of display advertising revenue amongst daily newspapers, lead by a 30% share of the weekly insert segment, and indicates a sustained 15+% range of market share shift in favour of The Globe and Mail, in one of the most competitive markets in North America using the Megawheels business model.
- Contracted with The Gazette Press Ltd., owner of 30 community newspapers in Alberta, to provide Megawheels' web and print technologies with the Red Deer Express and Central Alberta Advisor to the Red Deer and surrounding community. Megawheels' President and Founder, Marty Hilsenteger, has returned home with powerful business tools for his family's Chrysler & RV store and the other auto dealers of Central Alberta.
- Reorganized the Calgary Office for a more concentrated sales effort towards new opportunities with existing clients, linking Customer Support with Marketing and a stable R&D environment.
- Moved the Toronto office in the quarter to both an improved working environment and a lower cost base, with continued the investment in DMS R&D for a new release of Megawheels Drive Enterprise planned in Q2.
- Successfully updated Megawheels Showroom SE with enhanced features to all automotive dealers and deployed it to 200+ dealers within 5 business days.
- The Megawheels media platform, an early mover with Microsoft.Net technology, is now wireless capable; offering auto dealers the ability to digitize inventory, access information and conduct media transactions in a higher utility mobile environment. Automotive Manufacturers with certified used programs can now benefit from a media platform that simplifies content collection and increases advertising effectiveness, in a manner that ensures brand consistency in both on-line and in-print media.